Chapter 19

Sole Proprietorships — Wage and Billing Rates

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This chapter address the following areas:

- Establishing the sole proprietor’s billing rate.
- Establishing the overhead rate for a sole proprietorship.
- Establishing all-inclusive hourly rates for sole proprietorship firms.

A sole proprietorship is a company owned solely by one person. For tax purposes, the company’s net profits become the owner’s taxable income, and the net losses become the owner’s net loss for tax purposes.

For WSDOT purposes, there are several ways to look at calculating gross wages, hourly pay rates, and billing rates.

Sole Proprietor’s Billing Rate

As discussed in Chapter 20, the sole proprietor typically has a billing rate for services which is based on the going market rate for like services elsewhere. In reality, the owner of the firm takes draws against the profits of the firm. This results in a pay structure from month to month which can vary depending upon the firm’s business, and the owner’s need for cash.

Historically at WSDOT, the salary rate or billing rate for a sole proprietor has been negotiated on a case by case basis since the individual has no established salary.

Overhead Rate

The sole proprietor may or may not have employees. In developing a firm’s overhead rate, we then have two scenarios to work with.

Sole Proprietorships With No Employees

The auditors will want to know the exact number of hours the owner has worked directly on projects and indirectly on administrative matters. These hours, supported by time sheets, will ultimately play a role in development of the firm’s overhead rate.

Next, just as with any other firm, the indirect costs of the firm will be identified and verified by audit. An overhead rate will be calculated by dividing total allowable indirect costs by total direct labor. This is used for possible negotiation purposes.

This type of information is provided to management during a preaward audit, and the agreement for services negotiated accordingly.

The problem for the sole proprietor, or WSDOT manager, is that at the time of a post audit, if no preaward audit has been conducted, billed costs are usually questioned. This for the simple fact that the billed costs may not reflect actual costs or negotiated rates.

Direct nonsalary costs, and other associated costs which may be billed for services provided, must follow the basic guidelines indicated in Chapters 6 and 7.

Sole Proprietorships With Employees

In this scenario we have the same situation as described above in determining the owner's labor costs. The employees are normally paid an established salary.

This method uses a computed labor rate for the owner, identifying direct and indirect costs. The direct cost is then added to the direct labor base of the employees, with the computed indirect labor included in the indirect overhead labor value. Dependent upon the draws (salary) taken by the owner, this method should approximate an actual overhead rate for the firm.

In this scenario the key words are computed rates, or values, i.e., we are not talking about actual costs, in the sense of those associated with other type of firms, i.e., their direct labor and overhead costs.

Establishing the Sole Proprietorship All-Inclusive Hourly Rate

Typically, the billing rate for sole proprietorships has been negotiated due to the difficulty in establishing the owner's labor rate, and in establishing an overhead rate that is reasonable.

The method of payment for each type of agreement is up to the WSDOT contracting officer or consultant liaison working with the firm, and may vary from agreement to agreement.

The major problem with both of these scenarios is determining the proprietor's wage rate to be used in calculating the direct labor base. We expect that every sole proprietor would have set an expected, but reasonable, wage rate. Whether this rate is attained or not depends upon the profitability of the firm. Care must be taken to ensure that wage rates charged to WSDOT are not inflated to make up for losses on other agreements.

Factors to consider when determining a sole proprietor's wage rate include:

1. Total direct labor hours and total indirect labor hours.
2. Total annual amount of draws.
3. Proprietor's taxable income.
4. Proprietor's billing rate.
5. Proprietor's budgeted wage rate.

The decision as to what the sole proprietor's wage rate actually is will be made on the auditor's best judgment with the data available. Ideally, the proprietor will have time records identifying direct and indirect labor hours and draws will be approximately equal to a reasonable and expected wage rate.

Summary

In the end, the salary billing rate, overhead rate, and fixed fee for a sole proprietor or partners in a partnership may have to be negotiated with the WSDOT contracting officer.

Information developed during a preaward audit, or after the fact, during a post audit, at best may approximate what the actual costs are or should be for performing the work.

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